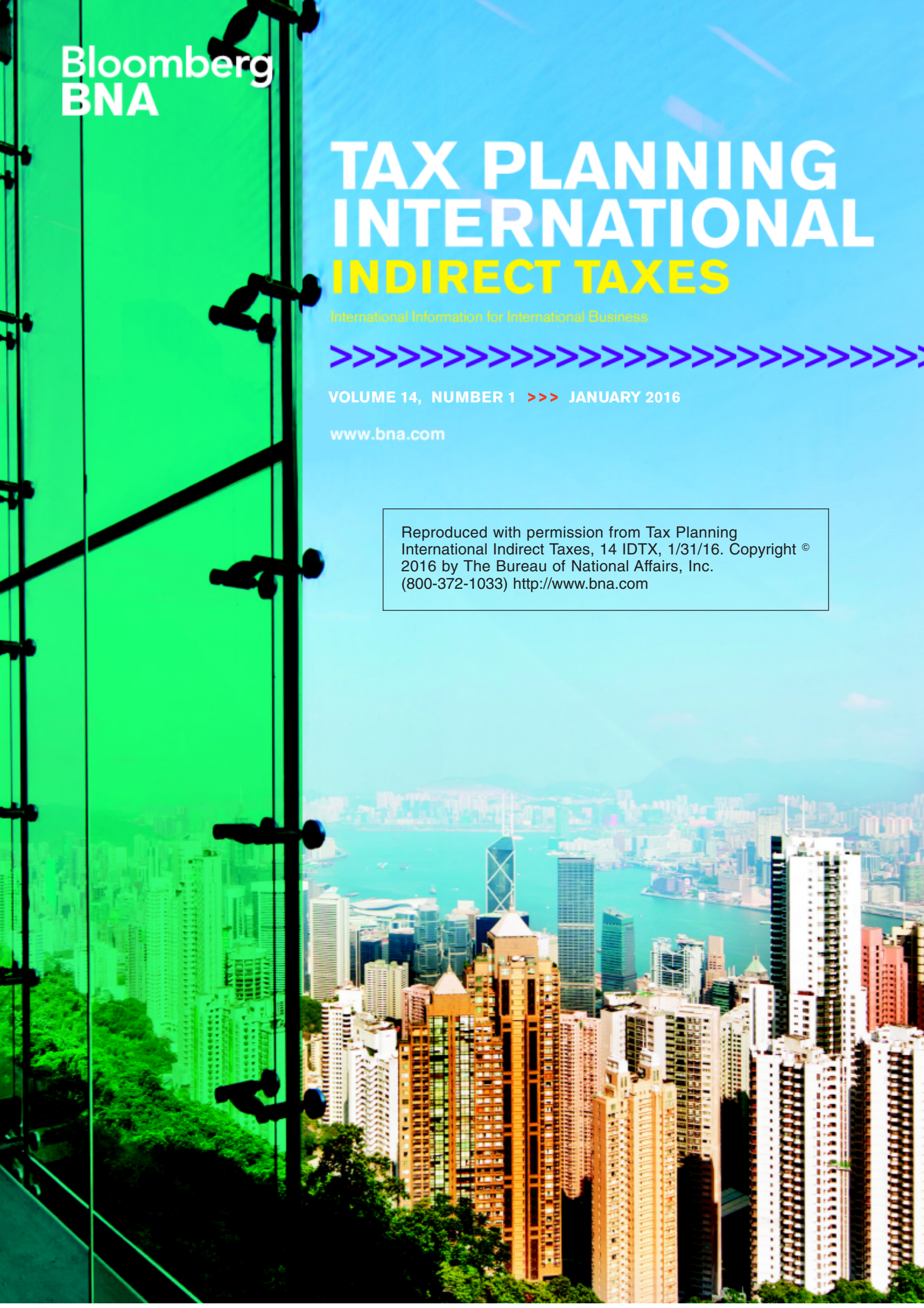

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CJEU Decision Regarding VAT Exemption for Management of Investment Funds

In its decision dated December 9, 2015 (C-595/13; *Fiscale Eenheid*), the Court of Justice of the European Union ("CJEU") has held that:

- the management of real estate funds that are subject to specific state supervision is VAT exempt according to Article 13B(d)(6) of Directive 77/388/EWG (the "VAT Directive"); and
- the VAT exempt management does not however encompass the actual management of immovable property.

The first principle has immediate impact on other types of funds, including German closed-ended alternative investment funds ("AIFs") such as private equity funds. The VAT exemption under EU law can also become available for such AIFs.

The Decision

The CJEU made the decision upon a request for a preliminary ruling referred to it by the Hooge Rad of the Netherlands ("Hooge Rad", order for reference dated November 21, 2013).

The Term "Special Investment Fund"

It was queried, first, whether real estate funds that are subject to a specific state supervision fall within the scope of the VAT exemption for "management of investment funds as defined by Member States" according to Article 13B(d)(6) of the VAT Directive. The CJEU affirms this to be the case.

Based on its previous judgments the CJEU states that the Member States' power to define the term "special investment fund" (i.e., investment vehicles the management of which is VAT exempt) is limited by the objectives of the VAT Directive and the principle of fiscal neutrality; undertakings for collective investments in transferable securities ("UCITS") are in any event "special investment funds" within this meaning.

Furthermore, investment vehicles which are (i) comparable to UCITS in respect of the competition conditions and circle of targeted investors and thus potentially in competition with UCITS, and (ii) subject to a specific state supervision, qualify as "special investment funds" in the view of the CJEU.

Comparability to UCITS

Such comparability requires that an investment vehicle raises capital from investors for investment purposes and that the investors participate in the performance of the investments through dividends (i.e. distributions) and enhancement in value of the fund interests. The CJEU explicitly states that the legal form of the special investment fund, the existence or non-existence of redemption rights and the asset class are not decisive in this context; investments in transferable securities are only one particular form of regulated investment.

State Supervision

According to the CJEU, the discretion of Member States regarding the definition of the term "special investment funds" is further superseded by the European harmonization of investment regulatory law.

UCITS and comparable investment vehicles qualify as "special investment funds" if they are subject to a specific state supervision. Such supervision can arise from the UCITS Directive, from another European regulatory regime or from national law. The latter aspect was relevant to the case at hand because it related to real estate funds (i.e. not UCITS, but AIFs) and to a period prior to the introduction of the Alternative Investment Fund Managers Directive ("AIFMD"). The CJEU explicitly states, however, that the AIFMD constitutes a specific state supervision as well.

According to the CJEU, specific state supervision means that there must be common basic rules for authorization, structure, activities and duties to publish certain information.

The Term "Management"

Furthermore, the Hooge Rad raised the question of whether the actual management of immovable property falls under the term "management".

The CJEU states that it does not, referring to its previous judgments pursuant to which "management" covers services that form a distinct whole and that are specific to, and essential for, the management of special investment funds, i.e., are related to the investment of the funded capital on account of the investors. The actual management of the immovable property is not regarded as specific within such meaning.

The latter principle is relevant for the scope of the VAT exemption for services used by real estate funds. Based on our experience, we would view the principle as coterminous with the existing praxis.

Consequences of the Decision

Unlike in most EU Member States, the management of closed-ended AIFs (such as private equity funds) is not VAT exempt in Germany. This is due to the fact that Germany interprets the VAT exemption granted by the VAT Directive for "the management of special investment funds as defined by Member States" very narrowly. The German legislation transposing this VAT exemption into national law (Section 4 (8) lit. h) German VAT Act) is limited to investment funds (*Investmentfonds*) within the meaning of the German Investment Tax Act (i.e., basically UCITS and open-ended real estate funds).

VAT Exemption for Closed-ended AIFs

Based on the reasoning of the CJEU, closed-ended AIFs that are subject to regulation under the German Capital Investment Act (i.e., the German AIFM law) must be classified as "special investment funds", i.e. must be granted the VAT exemption. The same should apply to AIFs or AIFMs which are subject to the EuVECA Directive (i.e., a distinct extensive supervisory regime).

The only question that could be raised is whether so-called sub-threshold special AIFMs and "mini" retail AIFMs (Sections 2 (4) and (4a) German Capital Investment Act) and sub-threshold AIFMs managing

retail AIFs (Section 2 (5) German Capital Investment Act) are subject to a specific state supervision, such that their management would be VAT exempt.

In our preliminary assessment, the answer is yes, since those AIFs are—as required by the CJEU—subject to common basic rules for authorization, structure, activities and duties to publish certain information. These AIFs or AIFMs must register with the German Federal Financial Supervisory Authority ("BaFin"), comply with the requirements relevant for such registration (i.e., qualification as a special AIF and/or calculation of certain thresholds), and oversee such compliance; they must have a certain legal form and be characterized by certain additional structural features (such as the absence of any obligation to make additional capital contributions); they must comply with certain marketing rules; and lastly they have reporting obligations vis-à-vis the BaFin.

This is all the more true for sub-threshold AIFMs managing retail AIFs (Section 2 (5) German Capital Investment Act). In addition to the above, they are subject to further requirements pursuant to the German Capital Investment Act (depositary, product regulation, risk diversification, etc.), i.e. they are subject to a specific state supervision. Thus, management of such retail AIFs should be exempt from VAT.

Need for Adaptation of German Law

The limitation of the VAT exemption to investment funds under the German Investment Tax Act is in our view inconsistent with the new CJEU decision, and thus violates European law. This is particularly evident in the context of AIFs that are subject to the full scope of authorization under the German Capital Investment Act and of EuVECA funds.

It is the responsibility of the German legislature to implement the criteria of the new CJEU ruling into national law, i.e. to extend the VAT exemption for management of investment funds to the aforementioned AIFs. It is to be hoped that this will occur in the near future.

Until then, it may be advisable for certain AIFs or AIFMs to ensure that VAT assessments do not become non-appealable (i.e. to lodge an appeal) and, as applicable, to make direct reference to Article 13B(d)(6) of the VAT Directive.

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